Supreme Court, U.S.
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No. 93-823

In The

Supreme Court of the United States

October Term, 1993

STATE OF NEBRASKA, DEPARTMENT OF REVENUE,

Petitioner,

v.

JOHN LOEWENSTEIN,

Respondent.

On Writ Of Certiorari
To The Supreme Court Of Nebraska

JOINT APPENDIX

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Petition For Certiorari Filed November 23, 1993
Certiorari Granted March 7, 1994

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IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, v. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	) Docket 428 Page 177))))))) PETITION FOR DECLARATORY JUDGMENT (Filed May 6, 1988)

COMES NOW the plaintiff and for his cause of action alleges as follows:

1. Plaintiff is a citizen of the State of Nebraska and a resident of Lincoln, Lancaster County, Nebraska.

2. Defendant, Department of Revenue, is the duly created agency and instrumentality of the State of Nebraska charged with the administration and collection of the Nebraska income tax.

3. This is an action for declaratory relief pursuant to Neb. Rev. Stat. ~~§ 25-21, 149 (1985 et seq.).~~ 84-911 (1987) challenging the validity of an agency rule. [/s/ TRW 7/1/88]

4. On the 31st day of December, 1986, the plaintiff owned 1,178.64 shares of the Trust for Short-Term U.S. Government Securities at a price per share of $1.00 each. Plaintiff purchased and sold shares of this trust from time to time throughout 1987.

5. On July 14, 1987, plaintiff purchased 4,444.41 shares of the Trust for U.S. Treasury Obligations at a price

per share of $1.00 each. Plaintiff purchased and sold shares of this trust from time to time throughout the remainder of 1987. On the 31st day of December, 1987, the plaintiff owned 17,513.86 shares of this trust.

6. The Trusts are no-load, open-end, diversified investment companies whose primary objective is to receive current income from their investment in U.S. Government securities and obligations. They do not engage in any other business.

7. The Trusts, which are principally located in Pittsburgh, Pennsylvania, are organized as Massachusetts Business Trusts, are qualified as regulated investment companies under Internal Revenue Code Subchapter M, and are established under the Investment Company Act of 1940. They are what is commonly known as "mutual funds."

8. The Trusts make it possible for investors to purchase U.S. Government securities in much smaller denominations than sold in the marketplace, and provide a distribution of the risk through a diversified portfolio. There is no minimum purchase requirement for investors who purchase through a fiduciary, such as a bank trust department.

9. The Trusts invest exclusively in short-term securities and obligations of the U.S. Government and its agencies and instrumentalities. Each of the federal securities held by the Trusts, if owned directly by the Trusts' shareholders, would be exempt from Nebraska income tax.

10. The Trusts invest in U.S. Government securities and Treasury Obligations directly and through repurchase agreements. The Trusts' repurchase agreement provides in Paragraph 18 that the intent of the parties is that the transaction be considered as a sale. Actual delivery is taken of the securities through the Federal Reserve book entry system. There is no promissory note executed in connection with the repurchase agreement, nor is there any indebtedness on behalf of the Trusts to the seller of the federal securities under the repurchase agreement. The sales price of the securities is the market value on the date of the repurchase agreement.

11. The income earned on each share of the Trusts is each share's proportionate fractional share of the total income realized from the underlying federal securities and obligations owned by the trusts, after deducting the administrative costs associated with the U.S. obligations. The Trusts have historically distributed all of their net income to their shareholders.

12. On September 11, 1987, Donald S. Leuenberger, then State Tax Commissioner, issued Revenue Ruling 22-87-4. This Ruling requires that for tax years after 1986, dividends from regulated investment companies owning obligations of the U.S. Government must be included within taxable income for purposes of the Nebraska Individual Income Tax unless 80% or more of the assets of the company for every quarter of the taxable year were directly owned U.S. Government obligations.

13. The defendant has advised taxpayers through the instructions included with the 1987 Nebraska Individual Income Tax forms that repurchase agreements covering U.S. Government securities cannot be counted

towards satisfying the 80% requirement of this Revenue Ruling.

14. In calendar year 1987, Plaintiff received dividends of $129.29, reflecting his share of the income of the Trust for Short-Term U.S. Government Securities and $734.61 reflecting his share of the income of the Trust for Treasurer Obligations.

15. In 1987, less than 80% of the assets of the Trusts consisted of U.S. securities directly owned by the Trusts.

16. As a result of the foregoing Revenue Ruling, defendant intends to impose the Nebraska state income tax on plaintiff's dividends for 1987 received from the Trusts. In addition, plaintiff believes that defendant intends to impose such a tax on any such dividends received by the plaintiff in 1988 and in future years.

17. Any imposition of an income tax by defendant upon the dividends received by plaintiff from the Trusts violates 31 U.S.C. § 3124(a) and the supremacy clause of the U.S. Constitution.

18. Plaintiff does not have an adequate remedy at law.

WHEREFORE, plaintiff prays that the court determine that Revenue Ruling 22-87-4 violates 31 U.S.C. § 3124, Neb. Rev. Stat. § 77-2716 (1987), and the supremacy clause of the U.S. Constitution and further declaring that dividends received by the plaintiff from the Trusts

are not includable within plaintiff's income for purposes of the Nebraska income tax.

JOHN LOEWENSTEIN, Plaintiff

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By: /s/ Terry R. Wittler
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IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, v. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	) Docket 428 Page 177) ANSWER) (Filed July 11, 1988)

Defendant State of Nebraska Department of Revenue, for answer to the petition filed herein, admits, denies, and alleges as follows:

1. Admits the allegations in paragraphs 1, 2, 3, 12, and 13.

2. For lack of knowledge, defendant denies the allegations of paragraphs 4, 5, 6, 7, 8, 9, 10, 11, 14, and 15.

3. Admits the allegation of paragraph 16, provided the dividends referred to therein fall within the purview of Revenue Ruling 22-87-4.

4. Denies the allegations of paragraphs 17 and 18.

5. Alleges the imposition of Nebraska income tax on dividends received by plaintiff from the Trusts in question does not violate 31 U.S.C. § 3124, Neb.Rev.Stat. § 77-2716 (Supp. 1987), or the Supremacy Clause of the U. S. Constitution.

WHEREFORE, defendant prays that the court determine that Revenue Ruling 22-87-4 is valid and constitutional in all respects, and does not exceed the statutory authority of the agency. Defendant further prays that the court dismiss plaintiff's petition, at plaintiff's cost.

STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant,

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BY /s/ L. Jay Bartel
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ATTORNEYS FOR DEFENDANT.

CERTIFICATE OF SERVICE

I hereby certify that I have served a copy of the foregoing Answer upon the plaintiff herein by placing a copy of the same in the United States Mail, first class postage prepaid, addressed to plaintiff's attorneys of record, Larry A. Holle and Terry R. Wittler, Cline, Williams, Wright, Johnson & Oldfather, 1900 FirsTier Bank Bldg., Lincoln, NE 68508, on this 11th day of July, 1988.

/s/ L. Jay Bartel
L. Jay Bartel
Assistant Attorney General

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, v. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	)	Docket 428 Page 177 FINDINGS OF FACT AND CONCLUSIONS OF LAW (Filed Nov. 19, 1990)

This matter came on for trial upon stipulated facts before the undersigned on Monday, July 23, 1990. *Exhibits 1, 2, and 3*, and the attachments thereto, were received by the Court without objection. The parties were directed to submit post-trial briefs, which they have done. The court, being fully advised in the premises, finds as follows:

FINDINGS OF FACT

1. The Trust for Short-Term U.S. Government Securities and the Trust for U.S. Treasury obligations (the "Trusts") are no-load, open-end, diversified investment companies whose primary objective is to receive current income from ownership of U.S. Government securities and obligations, either directly or through the use of repurchase agreements.

2. The Trusts do not engage in any other business.

3. The Trusts are qualified as regulated investment companies under Internal Revenue Code Subchapter M

and are established under the Investment Company Act of 1940.

4. The Trusts are what is commonly known as "mutual funds."

5. The Trusts make U.S. Government securities accessible to investors in much smaller denominations than sold in the marketplace and provide a distribution of the risk through a diversified portfolio of U.S. Government securities.

6. The Trusts invest in short-term securities and obligations of the U.S. Government and its agencies and instrumentalities either directly or through repurchase agreements. The Trusts hold no other securities.

7. The Trusts hold U. S. Government securities and Treasury obligations directly and through repurchase agreements.

8. Each of the federal securities held by the Trusts, either directly or through repurchase agreements, are "obligations of the United States . . . exempt from state income taxes under the laws of the United States" as that term is used in NEB. REV. STAT. § 77-2716 (1988 Cum. Supp.).

9. A typical repurchase agreement used by the Trusts was attached as *Exhibit A* to *Exhibit 2*.

10. A standard repurchase agreement ("repo") consists of a two-part transaction.

11. The first part consists of the transfer of specified securities by the seller to the buyer, in exchange for cash.

12. The second part consists of the contemporaneous agreement by the seller to repurchase the securities at the original sale price, plus an agreed upon amount of "interest," paid on a specified future date (the "Maturity Date").

13. Actual delivery is taken of the securities through the Federal Reserve book entry system.

14. There is no separate promissory note executed in connection with the repurchase agreement.

15. The repurchase price of the government securities subject to a repo is typically less than the market value of the securities.

16. For example, in the case of a two percent differential, the buyer will receive $1,020,000 of securities for the purchase price of $1,000,000.

17. The differential provides a margin of financial security for the buyer in case the securities decline in value and the seller fails to repurchase them.

18. The repurchase price of the securities is equal to the original sale price, plus the negotiated interest.

19. The interest paid by the seller upon repurchase is less than the interest rate accruing on the purchased securities.

20. The income earned on each share of the Trusts is each share's proportionate fractional share of the total income realized from the underlying federal securities and obligations owned by the Trusts, after deducting the administrative costs associated with the U.S. obligations.

21. The Trusts have historically distributed all of their net income to their shareholders.

22. On September 11, 1987, Donald S. Leuenberger, then State Tax Commissioner, issued Revenue Ruling 22-87-4, a copy of which was attached as *Exhibit B* to *Exhibit 2*.

23. This Ruling requires that for tax years after 1986, dividends from regulated investment companies owning obligations of the U.S. Government must be included within taxable income for purposes of the Nebraska Individual Income Tax unless 80 percent or more of the assets of the company for every quarter of the taxable year were directly owned U.S. Government obligations.

24. The defendant has advised taxpayers through the instructions included with the Nebraska Individual Income Tax forms for 1987 and subsequent years that repurchase agreements covering U.S. Government securities cannot be counted towards satisfying the 80 percent requirement of this Revenue Ruling.

25. At the end of each quarter of the tax year in 1987 less than 80 percent of the assets of the Trusts consisted of U.S. securities directly owned by the Trusts.

26. As a result of the foregoing Revenue Ruling, defendant maintains that plaintiff's dividends for 1987 and subsequent years received from the Trusts are subject to the Nebraska state income tax.

CONCLUSIONS OF LAW

1. This is an action for declaratory relief pursuant to NEB. REV. STAT. § 84-911 (1987).

2. The court has jurisdiction over the action and the parties.

3. The liquidity and flexibility provided by repurchase agreements are essential to the efficient functioning of the government securities market.

4. If the State of Nebraska were allowed to impose a tax on income from government obligations that are the subject of a repurchase agreement, it would impair the repurchase market and add to Treasury interest costs.

5. A Nebraska taxpayer is subject to a state income tax on his or her federal adjusted gross income under NEB. REV. STAT. § 77-2715(2) (1988), as modified by § 77-2716.

6. NEB. REV. STAT. § 77-2716(1)(a) exempts from Nebraska income tax "interest or dividends received by the owner of obligations of the United States . . . exempt from state income taxes under the laws of the United States."

7. Rev. Rul. 22-87-4 purports to limit the availability of this exemption to obligations "directly owned."

8. Title 31, U.S.C. § 3124(a), provides that:

> Stocks and obligations of the United States Government are exempt from taxation by a State or political subdivision of a State. The exemption applies to each form of taxation that would require the obligation, the interest on the obligation, or both, to be considered in computing a tax.

9. That provision represents a codification of prior law which was enacted in 1959 as Section 3701 of the Revised Statutes, 31 U.S.C. § 742. In addition to the language set forth above, the law in 1959 included the following language:

> This exemption [from state taxes] extends to every form of taxation that would require that either the [federal] obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax. . . .

Pub. L. 86-346, 105(a), 73 Stat. 622 (1959).

In 1982, when Congress recodified this provision as 31 U.S.C. § 3124(a), the words "directly or indirectly" were "omitted as surplus." H.R. Rep. No. 97-651, 97th Cong. 2d Sess. 94 (1982). The changes in language prompted by the recodification were not intended to make any "substantive change" in existing law. See *Id.* at 1-3. Therefore, although 31 U.S.C. § 3124(a) does not include the phrase "directly or indirectly," the statutory prohibition still extends to state taxes that indirectly, as well as directly, require the consideration of interest earned on, or the value of, federal obligations in their computations.

The limitation contained in Revenue Ruling 22-87-4 purporting to limit the exemption of taxation of interest from federal obligations to obligations "directly owned" violates 31 U.S.C. § 3124 and the Supremacy Clause of the U. S. Constitution.

10. The imposition of the Nebraska income tax on distributions from the Trusts to the Plaintiff reflecting his proportionate share of interest on federal obligations which are the subject of repurchase agreements would violate 31 U.S.C. § 3124(a) and the Supremacy Clause of the U. S. Constitution.

11. Revenue Ruling 22-87-4 is also invalid because it allows for an imposition of the Nebraska state income tax on one hundred percent of the distribution from a regulated investment company unless "for every quarter of the taxable year, 80% or more of the assets of a regulated investment company are directly owned United States government obligations." As a result, the Revenue Ruling allows for the imposition of the Nebraska state income tax on distributions representing the Plaintiff's proportionate share of interest on directly owned United States government obligations if they are part of a fund which cannot meet the 80% test.

12. The imposition of the Nebraska state income tax on any interest derived from United States obligations, regardless of the relative amount involved, is a violation of 31 U.S.C. § 3124 (a) and the Supremacy Clause of the United States Constitution.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that Revenue Ruling 22-87-4 is void and of no effect. Costs are taxed to the Defendant.

DATED this 19th day of November, 1990.

BY THE COURT:

/s/ Donald E. Endacott
Donald E. Endacott,
District Judge

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, vs. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	) Docket 428 Page 177 JOINT MOTION AND ORDER AMENDING PLEADINGS TO CONFORM TO THE PROOF (Filed Feb. 14, 1991)

The parties jointly move the court for an order pursuant to Neb. Rev. Stat. § 25-852 (1989) conforming the pleadings to the issues actually tried by allowing an amendment instanter by rider to the plaintiff's Petition as follows:

12A. On January 26, 1985, Donna Karnes, then State Tax Commissioner, issued Revenue Ruling 22-85-1. This ruling states:

> The interest income received from repurchase agreements involving obligations of the United States Government is income to the investor who provides the funds as a loan secured by Government securities. This interest income which is received from repurchase agreements involving obligations of the United States Government is subject to the Nebraska individual income tax. It is not to be subtracted from a taxpayer's federal taxable income on the Nebraska return.

The parties further stipulate that the prayer of the plaintiff's Petition be amended to include a request that Revenue Ruling 22-85-1 also be declared invalid.

JOHN LOEWENSTEIN, plaintiff

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By /s/ Terry R. Wittler
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STATE OF NEBRASKA DEPARTMENT OF REVENUE, defendant

By DONALD STENBERG,
Attorney General

By /s/ David E. Cygan
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2115 State Capitol
Lincoln, Nebraska 68509-4906

ORDER

IT IS SO ORDERED this 14th day of February, 1991.

BY THE COURT:

/s/ Donald Endacott
Donald Endacott
District Court Judge

IN THE DISTRICT COURT OF LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, vs. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	) Docket 428 Page 177 ORDER AMENDING "FINDINGS OF FACT AND CONCLUSIONS OF LAW" AND OVERRULING DEFENDANT'S MOTION FOR NEW TRIAL (Filed Feb. 14, 1991)

This matter came before the court upon the parties' "Joint Motion Amending Pleadings to Conform to the Proof" and upon the defendant's Motion for New Trial. The court has sustained the Joint Motion. Accordingly, the court's "Findings of Fact and Conclusions of Law" are amended by adding the following finding of fact:

22A. On January 26, 1985, Donna Karnes, then State Tax Commissioner, issued Revenue Ruling 22-85-1. This ruling states:

> The interest income received from repurchase agreements involving obligations of the United States Government is income to the investor who provides the funds as a loan secured by Government securities. This interest income which is received from repurchase agreements involving obligations of the United States Government is subject to the Nebraska individual income tax. It is not to be subtracted from a

taxpayer's federal taxable income on the Nebraska return.

The court's findings are further amended by adding the following conclusions of law:

7A. Rev. Rul. 22-85-1 purports to limit the availability of this exemption to obligations which are not the subject of repurchase agreements.

9A. The limitation contained in Revenue Ruling 22-85-1 purporting to limit the exemption of taxation of interest from federal obligations to obligations which are not the subject of repurchase agreements violates 31 U.S.C. § 3124 and the Supremacy Clause of the U. S. Constitution.

Finally, the last paragraph of the court's Order of November 19, 1990 is amended to read as follows:

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED that Revenue Rulings 22-85-1 and 22-87-4 are void and of no effect. Costs are taxed to the defendant.

Defendant's Motion for New Trial is denied.

DATED this 14th day of February, 1991.

BY THE COURT:

/s/ Donald E. Endacott
Donald Endacott
District Court Judge

PREPARED BY:

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IN THE DISTRICT COURT OF
LANCASTER COUNTY, NEBRASKA

JOHN LOWENSTEIN, Plaintiff, vs. STATE OF NEBRASKA, DEPARTMENT OF REVENUE, Defendant.	)	Docket 428 Page 177 FIRST STIPULATION OF THE PARTIES (Exhibit No. 1 Received July 23, 1990)

COMES NOW the parties, by and through their undersigned attorneys, and hereby stiuplates [sic] to this court that the depositions of Stewart Brown and Peter Sternlight taken in the proceeding *Page v. Department of Revenue, State of Florida,* in the Circuit Court of the 9th Judicial Circuit for Orange County, Florida, or true copies thereof, will be submitted into evidence in the above captioned proceeding without objection from the parties.

Respectfully submitted,

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Attorney General

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For the Parties.

32-176-13

IN THE CIRCUIT COURT OF THE NINTH JUDICIAL CIRCUIT, IN AND FOR ORANGE COUNTY, FLORIDA

CASE NO.: CI 87-2586

JAMES F. PAGE and
ELIZABETH K. PAGE,

Plaintiffs,

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Defendant.

****

TELEPHONIC
DEPOSITION OF: PETER D. STERNLIGHT

DATE: Wednesday, December 2, 1987

TIME: 9:31 o'clock, a.m.

PLACE: GRAY, HARRIS & ROBINSON, PA
Suite 1200
205 East Pine Street
Orlando, Florida 32801

REPORTED BY: Abby L. McClain, Court
Reporter and Notary Public

****

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Attorney for the Deponent

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[p. 3] WHEREUPON:

The following proceedings were held:

PETER D. STERNLIGHT

the Witness herein, after having first been duly sworn by the Court Reporter, testified and was examined under his oath as follows:

DIRECT EXAMINATION

BY MR. PAGE:

Q. State your name for the record, please, sir.

A. Peter D. Sternlight, S-t-e-r-n-l-i-g-h-t.

Q. Where are you employed, Mr. Sternlight?

A. The Federal Reserve Bank of New York.

Q. How long have you been employed there?

A. Since 1950.

Q. 19–

A. Five oh, since 1950, with some time out for military service and a period when I was working for the Treasury Department in Washington.

Q. All right. And what is your current function at the Federal Reserve Bank of New York, sir?

A. I'm manager of the Federal Reserve System Open Market Account for Domestic Operations, and also, I'm an Executive Vice-President at the Federal Reserve Bank.

Q. All right. What is your training, sir?

A. I have academic training as an economist. I have [p. 4] an M.A. and Ph.D. from Harvard in Economics, and I've worked at the Federal Reserve Bank during my professional career except, as I mentioned, I was for two years at the Treasury Department in 1965 to '67. I was Deputy under the Secretary for Monetary Affairs.

Q. All right, sir. Did you have occasion to give an affidavit in the case of Bevil, Bresler & Schulman Asset Management Corporation that was pending in the United States District Court for the District of New Jersey, it's Civil Case Number 85-1728?

A. Yes, I did.

Q. And do you happen to have a copy of that affidavit in front of you, Mr. Sternlight?

A. I do.

Q. Were you under oath at the time that you signed this affidavit, sir?

A. Yes.

Q. Would your – does the affidavit reflect your current opinion as to how repurchase agreements should be categorized?

A. I would say so, yes.

Q. If you were to make a similar affidavit at this time along similar subject lines, would your testimony be any different, or would your affidavit be any different than would be contained in the affidavit before you?

[p. 5] A. Not in substance, but there would be some updating of some of the statistics in there, but the essential points made would be the same.

Q. All right, sir. And is the affidavit in front of you a five-page affidavit?

A. Yes, it is.

Q. And is it dated April 11, 1986?

A. Yes, that's correct.

MR. PAGE: That's all the questions I have, sir.

I'd like to attach a copy of the affidavit to the deposition.

Go ahead with your Cross-Examination, Mr. Brown, please.

CROSS-EXAMINATION

BY MR. BROWN:

Q. Hello, Mr. Sternlight. How are you this morning?

A. Just fine, thanks, Mr. Brown.

Q. Mr. Sternlight, are you at all versed or have a degree in law from any university?

A. No, I do not.

Q. Now, you are with the Federal Reserve Bank in New York, as I understood your testimony?

A. That's right.

Q. Now, I understand that part of the function of the Federal Reserve Bank in New York and the Federal Reserve [p. 6] System as a whole is to control the money supply in this country; is that right?

A. That's correct, yes.

Q. And that you control the money supply in large part by purchasing and selling United States Government Securities to banks; is that true?

A. To purchase and sell securities to dealers in the market, some of which are banks, yes.

Q. All right, sir. And is the substance of what I just said to you correct?

A. Yes.

Q. Is that your major function, major way you control the money supply, to buy and sell United States Government Securities?

A. Yes, essentially.

Q. Okay. Now, as I understand your affidavit that you're referring to, there are short-term and quick adjustments that sometimes need to be made in the nation's money supply; is that right?

A. There are short-term adjustments in the reserves available in the banking system. That's the means

through which we influence growth with the money supplies by affecting the availability of bank reserves.

Q. All right. In any event, directly or indirectly, you've got to make changes in the reserves sometimes on a [p. 7] short-term and quick basis; is that true?

A. True.

Q. Would you say that's a function of the Federal Reserve System?

A. I would say so, yes.

Q. Now, it would be much more difficult to make those short-term modifications to reserves, would it not, if you were not able to use repurchase agreements to make those short-term adjustments?

A. I believe that is correct, yes.

Q. It is true, then, that it is in the interest of the Fed, the Federal Reserve System, to have repos, resale repurchase agreements characterized in such a manner that the Fed can continue to use them?

A. I think that's fair to say, yes.

Q. And isn't it true that if these agreements were not characterized as United States Government obligations, the Federal Reserve System would be preluded statutorily from engaging in such transactions?

A. I don't think the transactions have to be characterized as Government obligations, to my mind. I'm not speaking as a lawyer, you understand. It's the – we regard these – what we're doing is purchases and sales of

U.S. Treasury obligations, I wouldn't say that the transaction itself is a U.S. obligation.

[p. 8] Q. Let me ask the question differently.

If it were found consistently that these transactions which you characterize as purchase and resale transactions were found to be in essence secured to collateralized loans from the buyer to the seller, isn't it true that the Fed would not be allowed by law to engage in such transactions?

A. From what our Counsel tells us, we would have difficulty finding our way to do that, if they were regarded as loans.

Q. All right.

Now, putting aside the regulatory inhibitions that every government or quasi government agency has to deal with, and putting aside the legal niceties and technicalities of how these transactions are generally structured, would you agree as an economist that it's fair to say the economic substance of a transaction, what happens in the mind of an economist or financial analyst is really a collateralized credit agreement between the buyer and seller?

A. From a standpoint of its economic function, I would say it's very close to a collateralized loan, yes.

Q. All right. Now, sir, have you seen any of the – have you seen what's known as a general or master repurchase and sale agreement that is used by this particular trust [p. 9] fund that we're talking about here today? And that's the trust for short-term United States Government Securities. Have you been supplied a copy of that?

A. No, I have not seen that.

Q. And have you seen any of the terms of such a contract that is used by this particular fund?

A. Not – it wasn't presented to me as being used by that fund. I have glanced at some general repurchase agreements, contracts, and maybe they're similar to that particular one, but certainly it was not in connection with anything related to that particular entity.

Q. Has Mr. Page, who questioned you earlier, supplied you with such a document in the last day or two?

A. No.

Q. Are you familiar, sir, with the treatment that the income from repo agreements, sales, repurchase agreements of Government Securities, receives under the Federal Income Tax Code?

A. I cannot say I have an expert familiarity with that, no.

MR. BROWN: Okay, I have no further questions.

MR. PAGE: Okay.

MR. MALONEY: I have one question I would like to ask him.

(Continued on Page 10)

[p. 10] CROSS-EXAMINATION

BY MR. MALONEY:

Q. Mr. Sternlight, this is Eugene Maloney from Federal Investors. I have a follow-up question on a point I

think you were alluding to in your earlier discussion with Mr. Brown.

Would it be fair to characterize –

MR. BROWN: I'll object to the form of this question. He's your witness and you're leading him, but outside of that –

MR. PAGE: Okay.

BY MR. MALONEY:

Q. Was the point you were attempting to make in your earlier response to Mr. Brown's question that a repurchase agreement is essentially a transaction, but the result of the transaction constitutes, in your opinion, either the purchase or sale of a U.S. Government Security; i.e., can you distinguish the transaction itself from the actual result of the transaction?

A. I'm trying to weigh that question, sir. I'm not really sure I understand it clearly enough.

Q. Well, in your opinion, is the result of a repurchase agreement transaction the purchase or sale of a U.S. Government Security?

A. Yes, I would say that if the repurchase [p. 11] transaction is comprised of sales and purchases of U.S. Government Securities, if it's done in U.S. Government Securities, they can be in other instruments, of course.

MR. MALONEY: Okay.

MR. BROWN: I do have one other question, if you'll indulge me.

MR. PAGE: All right.

FURTHER CROSS-EXAMINATION

BY MR. BROWN:

Q. Mr. Sternlight, I did miss one question I was asking before.

MR. RINGSMUTH: Who's speaking, please?

THE WITNESS: Mr. Brown.

MR. BROWN: Yes, Mr. Brown.

BY MR. BROWN:

Q. I presume the Federal Reserve Bank itself at times becomes involved as a buyer in this sale, repurchase transaction that you're testifying about.

A. Yes.

Q. And when you do, do you require a margin of your seller?

A. We, in effect, do because we've –

Q. You require a haircut?

A. No, we take a haircut in the valuing.

Q. Would you explain for the record, please, what a [p. 12] haircut is?

A. Well, if we were doing a – a one million dollar transaction, we would purchase – we would make sure that we were purchasing securities. Before we spent our million dollars, we would want to be sure that we were

purchasing securities that were worth slightly more than that one million dollars that we would take in and hold.

Q. So if a security that you were thinking about purchasing had a value of one million dollars, you would pay less than one million dollars for it; is that correct?

A. Yes.

Q. And you would do that to – in essence, to protect yourself from market fluctuations in the value of that security while you held it; is that correct?

A. That is true.

Q. And you require interest upon the repurchase price; do you not?

A. Yes.

MR. BROWN: I have nothing further. Thank you.

MR. PAGE: Mr. Sternlight, I have just a few questions.

MR. RINGSMUTH: Would the questioner identify himself, please?

MR. PAGE: Yes, sir, this is Mr. Page again.

(Continued on Page 13)

[p. 13] REDIRECT EXAMINATION

BY MR. PAGE:

Q. You do business with certain companies that are on an approved list, I presume, for repurchase agreements; is that correct?

A. That's right.

Q. Does the Fed seek out financial information about the solvency of those companies?

A. Yes. We get reports from them on their activity, including balance sheet information.

Q. And the Fed would have certain rights under their repurchase agreements in the event of a default by one of those repurchase sellers; would they not?

A. Yes.

Q. Are you generally familiar with the terms of repurchase agreements as are used in the U.S. Government Securities market?

A. Well, I think generally familiar, not as a legal expert.

Q. Okay. Does the Fed have such an agreement that it uses typically, or do you use the agreements from the various companies you do business with?

A. Oh, we have our own agreement that we use with our counterparties.

Q. And how many page document is that; do you have [p. 14] any idea?

A. I don't remember offhand, sir.

Q. Would that be something that would be available that we could have Faxed to us today?

A. Yes, I think so.

Q. All right. I would ask that you, you or Mr. Ringsmuth, if you can conveniently do so, Fax one to us, and I would like to attach it to this deposition when I receive it.

A. We'll do that, surely.

MR. BROWN: That is not without objection on my part –

MR. PAGE: I understand.

MR. BROWN: – but I want you to understand that.

MR. PAGE: I understand.

BY MR. PAGE:

Q. And do you have – by chance a copy of that in you office right there available to you now, sir?

A. I do not, no.

MR. PAGE: Okay. That's all the questions I have at this time.

Mr. Sternlight, you have the right to read and sign this deposition when it's transcribed, which it's going to be here in the next hour, or you can waive your right and depend on the accuracy of the Court [p. 15] Reporter. We would hope that you would waive that right so that we could use this deposition at the trial in this case this afternoon, but you have that right, sir, to exercise one way or the other.

THE WITNESS: No.

MR. RINGSMUTH: He has no objection to that, but we do ask that you transmit by Facsimile the transcribed transcript when it's available.

MR. PAGE: We'll be happy to do that. Thank you very much.

THE WITNESS: All right.

MR. PAGE: We appreciate your help and cooperation.

STIPULATIONS: It is hereby stipulated and agreed to by and between Counsel for the respective parties and the Deponent, that the reading and signing of this deposition be waived.

(Whereupon, subsequent to the close of the deposition, the document was marked as Plaintiffs' Exhibit Number 1) (Whereupon, this deposition was concluded at 9:56 o'clock, a.m.).

[p. 16] CERTIFICATE

STATE OF FLORIDA :

COUNTY OF ORANGE :

I, ABBY L. McCLAIN, being a Stenotype Shorthand Reporter and Notary Public, State of Florida at Large, do hereby certify that I did, at the time and place herein designated, place under oath the Deponent, PETER D. STERNLIGHT, who was thereupon examined; that said examination was recorded, by me, in Stenotype notes which were later reduced, by me, through computer-aided transcription, to typewritten form; and that the foregoing pages, numbered 3 through 15, inclusive, constitute a true, complete and accurate transcription of my said Stenotype notes taken therein.

I further certify that I am neither of counsel nor related to any party involved in this action, nor am I financially interested in the outcome of this case.

WITNESS MY HAND AND OFFICIAL SEAL, on this, the 2nd day of December, 1987, in the City of Orlando, County of Orange, State of Florida.

ABBY L. McCLAIN
Court Reporter
Notary Public

My Commission Expires:
March 4, 1991

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEW JERSEY

In the Matter of: BEVILL, BRESLER & SCHULMAN ASSET MANAGEMENT CORPORATION, Debtor.	(Hon. Dickinson R. Debevoise) Civ. No. 85-1728 Chapter 11
SAUL S. COHEN, Trustee of Bevill, Bresler & Schulman Asset Management Corporation, Plaintiff, vs. ARMY MORAL SUPPORT FUND, et al., Defendants.	Adversary Proceeding No. 85-2103
In re: BEVILL, BRESLER & SCHULMAN, INC., Debtor.	Civ. No. 85-2224
RICHARD W. HILL, Trustee for the liquidation of Bevill, Bresler & Schulman, Inc., Plaintiff, vs. FIDELITY NEW YORK, F.A., et al., Defendants.	Adversary Proceeding No. 85-5274

STATE OF NEW YORK)
) ss:
COUNTY OF NEW YORK)

AFFIDAVIT OF PETER D. STERNLIGHT

1. I am Executive Vice President of the Federal Reserve Bank of New York ("FRBNY") with responsibility for the Open Market Operations Function.

2. I have had experience at the FRBNY's open market trading desk since the 1960's, and for the past six years I have been Manager of the System Open Market Account ("SOMA"). In that capacity, I have responsibility for a variety of types of transactions undertaken by the FRBNY open market desk for the account of SOMA. The object of those transactions is to adjust the level of bank reserves in order to achieve the Federal Open Market Committee's monetary policy goals. FRBNY also carries out transactions in the market on behalf of foreign central banks to aid them in their dollar investments.

3. Repurchase agreements involving United States Treasury issues and certain other agency issues are essential to the operations of the open market desk for reserve adjustments. In addition, the liquidity and flexibility provided by repurchase agreements are essential to the efficient functioning of the government securities markets. Repurchase agreements are unique vehicles for short-term, high-volume financing. As used in the market today, repurchase agreements are viewed generally as contracts for the sale of securities and their resale back to the original seller at a future date. An essential feature of this arrangement is that securities delivered under a

repurchase agreement are freely transferable and unencumbered by restriction from previous transfers.

4. During 1985, the FRBNY conducted SOMA transactions in the market in the aggregate amount of $212 billion. Of these, 74 percent were repurchase transactions, and 17 percent were reverse repurchase transactions (known to FRBNY as matched sale-purchase agreements). Thus, only 9 percent of the 1985 SOMA market transactions conducted by the FRBNY were conducted without the use of repurchase or reverse repurchase agreements. Also during 1985, the FRBNY conducted $188 billion worth of transactions in the market on behalf of approximately 150 foreign central banks and other foreign official institutions. Of these, some 62 percent were repurchase transactions. Federal Reserve operations in the market on a single day through repos or reverse repos often come to $3-4 billion and have reached as high as 7.9 billion.

5. The FRBNY repurchase transactions are, by statute, structured and conducted as contracts for purchase-and-sale. The high volume of Federal Reserve open market operations requires the broadest possible repurchase market for government securities. It is doubtful that the FRBNY would have access to a market for repurchase agreements characterized as secured loans. Such a result could impair the FRBNY's ability to maintain appropriate levels of bank reserves from week to week, diminish the FRBNY's ability to achieve reserve growth objectives, and possibly accentuate interest rate volatility.

6. Repurchase agreements are an important method for dealer financing of their inventories of United States

government securities. The primary dealers typically underwrite a sizeable [sic] portion of new Treasury issues – 35-75 percent – and rely heavily on temporary financing through repurchase agreements pending resale of the issues to other investors. Clearly, an impairment of the repo market would make it less attractive for dealers to perform this very useful underwriting function, thus adding to Treasury interest costs.

7. Repurchase agreements are a major vehicle in the market-making process, providing the means for creating hedges and arbitrages among various issues and thereby increasing liquidity. Through these transactions, the dealer market adds to the close substitutability among Treasury issues, enhancing the attractiveness of the market for a variety of participants, which in turn increases the market for Treasury issues. If repurchase agreements were to lose their present characteristics of flexibility and liquidity, the dealer market – a critical element in the process of financing the national debt through Treasury issues – would be handicapped. More generally, a hobbling of the repo market could have broad rate effects throughout the financial markets, diminishing efficiency and the allocation of resources. Market participants would turn to less liquid forms of investment that would tend to produce higher rates in the economy at large. Greater volatility of rates as a consequence of a diminished repo market could add to average rate levels.

8. Repurchase agreements have proven to be invaluable to a wide variety of institutional investors, both public and private. A significant number of participants in the market are public entities who face constitutional, statutory, or regulatory restrictions on lending and

borrowing activities, but can and do rely on repurchase agreements to achieve investment, cash management and liquidity needs. If repurchase agreements, with their present characteristics (including unencumbered transferability of securities delivered under repo contract), and in their present form and as presently understood in the market (contracts for the sale and repurchase of securities) were unavailable to these participants in the market, the more costly financing alternatives would have adverse consequences for the entities involved, and their withdrawal from the government securities market as repurchase participants would adversely impact the market.

9. Repurchase agreements, as used and understood by the FRBNY in conformity with recognized and accepted market practice, are agreements for the transfer of securities with a simultaneously executed agreement to retransfer securities back to the original seller at a specified future date. They are structured and treated as sales and repurchases, unencumbered by any restriction from prior transfer that would impede further transfer. This treatment is essential to the purposes for which repurchase agreements are employed: high-volume, short-term financing transactions.

/s/ Peter D. Sternlight
Peter D. Sternlight

Subscribed and sworn
to before me this 11th
day of April, 1986

/s/ Margaret M. Manuel
Notary Public

MARGARET M. MANUEL
Notary Public, State of New York
No. 30-4825241
Qualified in Nassau County
Certificate filed in New York County
Commission Expires May 31, 1989

IN THE CIRCUIT COURT OF THE NINTH JUDICIAL CIRCUIT, IN AND FOR ORANGE COUNTY, FLORIDA

CASE NO: CI 87-2586

JAMES F. PAGE and
ELIZABETH K. PAGE,

Plaintiffs,

COPY

vs.

DEPARTMENT OF REVENUE,
STATE OF FLORIDA,

Defendant.

****

DEPOSITION OF:	STEWART BROWN
DATE:	Wednesday, December 2, 1987
TIME:	10:10 o'clock, a.m.
PLACE:	GRAY, HARRIS & ROBINSON, PA Suite 1200 205 East Pine Street Orlando, Florida 32801
REPORTED BY:	Abby L. McClain, Court Reporter and Notary Public

****

APPEARANCES:

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* * *

[p. 3] WHEREUPON:

The following proceedings were held:

STEWART BROWN,

the Witness herein, after having first been duly sworn by the Court Reporter, testified and was examined under his oath as follows:

DIRECT EXAMINATION

BY MR. PAGE:

Q. State your name for the record, please.

A. Stewart L. Brown.

Q. Okay. And where are you employed, Mr. Brown?

A. I work at Florida State University.

Q. Okay, in what capacity?

A. Associate Professor Finance.

Q. And what is your background and training educational-wise?

A. I have a B.S. and M.B.A. and Ph.D. in Finance from the University of Florida. The Ph.D. I got in December of '74.

Q. Okay. And what have you done vocationally since you graduated from the University of Florida?

A. I taught at Florida State University.

Q. And what courses do you teach at F.S.U.?

A. I teach finance courses, and I teach money capital markets, bank management, investments at the undergraduate, [p. 4] graduate and advanced graduate level. I've taught in options and commodities. In general, I teach in the area of investments and money and capital markets.

Q. You do any consulting?

A. Yes.

Q. What types?

A. I have had a relationship with the State Board of Administration since September of '83. The State Board is the State Pension Fund, currently about thirteen billion dollars. And I also do expert witness work in the securities area.

Q. And what is your relationship with the State Board of Administration?

A. I am a paid consultant. I am on an annual retainer with them.

Q. What do you consult on; types of investments they should make?

A. In general, I bring the academic perspective to the Board. I sit in on presentations from people from Wall Street. And the way you characterized it is correct. I consult on various investment opportunities that they have.

Q. Okay. And I presume you were contacted in this case just shortly ago.

A. Yes, sir.

Q. What have you reviewed in preparation for your [p. 5] testimony here today or at trial?

A. I have reviewed various documents from the mutual fund, I don't know how to characterize them, their prospectus. There's a master repo agreement, there's a – an example repo transaction. I've also done a – I went to the library and did a literature search on repos, and I went through the – what had been written by Marsha Stigum in The Money Market.

Q. Who is Marsha Stigum?

A. Marsha Stigum –

Q. How do you spell that?

A. S-t-i-g-u-m – is a Ph.D. economist who has written a book called The Money Market, I have the revised edition, and it's more or less the Bible of money market transactions.

I also reviewed my notes from courses I teach to refresh myself, and glance through various investment textbooks.

Q. Okay. And what did your literary research reveal?

A. Not much. A couple of articles that were written after the – basically the two articles I found came from accounting journals that were written basically after the ESM debacle down in Fort Lauderdale, educating accountants on what to look for and understanding repo transactions, since a good part of the ESM problem did involve some fraud [p. 6] on the part of a C.P.A. firm. So it didn't reveal anything that I didn't know aside from a few details.

Q. Are you proposing to offer any of these articles as evidence in your testimony this afternoon?

A. No.

Q. So you looked at the two articles regarding the accountant and repo agreements plus Marsha Stigum's article or book?

A. Yes, and glanced through some textbooks.

Q. Okay. What opinions are you prepared to offer today?

A. The essence of the opinion is that the economic substance of a repo transaction, if you look through the legalities of what is really going on, is a collateralized loan between a lender and borrower.

Q. Okay. Have you reviewed any law – cases in preparation for your testimony?

A. I did glance at one, and I can't remember the name of it. It was the one involving the State of Florida. Gibney (ph) comes to mind.

Q. Gilmore?

A. Gilmore. Gilmore versus the State of Florida.

Q. And in that situation, the Court found that it was not a collateralized loan, it was a purchase and sales transaction; is that correct?

[p. 7] A. That's my understanding, yes, sir.

Q. And do you have any problem with the decision of the Court in that case?

A. Well, like I said, I just glanced at it. My understanding of it is that there was – that the case turned. Again, I'm not an attorney and I have only the vaguest notion, but the case turned on a point of contract law on whether indeed there was an agreement to resell. And it – I may not be characterizing it right, but the essence I got out of it, that that case is substantially different from this case, since in this case, in looking at the repo, the agreement, there is – there's a lot of difference, is the essence of what I came away from it with.

Q. Okay. And have you analyzed the repo agreement to – that you were provided with in this case?

A. Yes, I have.

Q. All right. And is this repo agreement typical of repo agreements that are used in the U.S. Government Securities market?

A. My sense of it is, yes. And I have not reviewed a lot of repo agreements, so I don't know, but it is entirely in keeping with everything that I've read and everything that I know about the repo market.

Q. Okay. How many times have you looked at the repo issue?

[p. 8] A. This is really the first time I've looked at it in detail. I have taught about it and taught the essence of repo transactions for – well, ever since they really became widely used in the late seventies, but this is the first time I have looked at the issue – specific issue of repos in depth.

Q. How would you define a repo?

A. A definition of a repo?

Q. Um-hmm.

A. Is, I would say, that a repo is a transaction, a securities market transaction between a lender and borrower that involves the legal title of transfer, that the transfer of legal title between the borrower and the lender is a means of collateralizing the loan, so the essence of the economic transaction is that a lender lends money to the borrower and protects a lien against his collateral by taking legal title to the security.

MR. MALONEY: Dr. Brown, is that the definition you would give your –

MR. BROWN: I'm sorry to make an objection. I don't mind one attorney questioning, but I don't want you double-teaming him. I think that's fair.

MR. PAGE: That's generally the way we do it here. Why don't you slip me a note.

MR. MALONEY: All right.

[p. 9] BY MR. PAGE:

Q. Had you finished your answer?

A. If I was going to define this for my students, I would say something like a repo transaction is a short-term money market transaction involving the transfer of funds from a lender to a borrower, and the transfer in the opposite direction from the securities – from the borrower to the lender to secure the loan, and the essence of the transaction is that of a collateralized loan. And I would say something very like that in a classroom.

Q. And how is that – is the security interest in the collateralized loan perfected? Do you have any knowledge of that?

A. No, I'm not an attorney. My sense of it is, some form of title does pass and that's the legal artifact in doing the transaction.

Q. Is there a promissory note executed in connection with the –

A. Typically not.

Q. – transaction?

A. Typically not, is my understanding.

If there was these general agreements that – and again, I'm not an attorney, so I don't know how to characterize it.

Q. You heard Dr. Sternlight's deposition.

[p. 10] A. Yes.

Q. He characterizes the repo agreement as a purchase and sale. Do you –

A. I don't agree with that. I think he said the essence of it economically is that it's a collateralized loan. I heard him say that very definitely.

Q. He also said, I think he said it in his affidavit, that he characterizes such transactions as purchases and sales. Do you disagree with that?

A. No, I don't disagree that there is a sale and a repurchase, that there is some sort of legal title to the securities in the nature given the – in the transaction. The nature of those securities gets changed, that the holder of the purchase – of the security doesn't get to keep the interest on them, that there is – that there's margin against the security.

In essence, the parties in the transaction are acting like lenders and borrowers rather than one selling the – if somebody wanted to buy a security, they could buy it outright in the securities market, they don't need to do it under a repo.

Q. Do you understand what the definition, the Federal Reserve Board definition of a repurchase agreement is?

A. No.

Q. Okay. Is this your Curriculum Vitae?

[p. 11] A. Yes, it is.

MR. BROWN: Yes, it is.

Would you like to make a copy of it and have it attached?

BY MR. PAGE:

Q. Are you aware that the Federal Reserve Bank of Richmond has published a definition of a repurchase agreement as the actual purchase and sale of a U.S. Government Security?

A. No, I was not aware of that.

Q. Would you – if, in fact, you were confronted with that, how would you respond to that?

A. I would respond a couple ways. I would respond that the Federal Reserve Bank of Richmond has a vested interest in defining a repo that way, for reasons that were articulated in the earlier deposition.

Q. Um-hmm.

A. The way the Fed operates is made much easier if they can call this thing a sale and repurchase and not a collateralized loan.

My second response would be that you can legally define something in a particular way. And I'm not an

attorney, but if you look through the economic essence of this transaction, it's clearly a collateralized loan.

Q. Okay. If it's in the interest of the Fed to [p. 12] define it that way, would it be in the interest of the country as a whole to define it that way?

A. Strictly from a monetary perspective, I believe so. I can't say about the interest of everybody, taking everything into account.

From conducting a monetary policy, it's clearly made easier if the Fed can operate in the repo market.

Q. And the repo market is the way the national debt is financed; is it not?

A. No. No.

The repo market – the big players in the repo market are the thirty-six primary U.S. Government Securities deals. Of course, there are secondary dealers and boutiques, if you will, and they basically are in the business of making a market of U.S. Government Securities. But at any one point in time, and I don't know the exact numbers, but I suspect that the U.S. Government dealers hold a relatively small proportion of the total debt outstanding, the rest is out in the hands of mutual funds and banks and pension funds and the like.

Q. Have you ever reviewed the case of Bevill, Bresler & Schulman?

A. No, I have not.

Q. So basically, if I understand what you're saying, Dr. Brown, you're not trying to give a legal definition of

[p. 13] repurchase agreement, you're trying to give a definition from an economics standpoint?

A. That's correct.

Q. Would you explain your understanding of how the Fed uses the repo market?

A. Sure. The job of the Federal Reserve is to control the money supply of the country, typically defined as coin currencies and demand deposits. Demand deposits are checking accounts of the banking system.

The way that the Federal Reserve controls the money supply is by controlling the reserves of the banking system, defined as vault cash and deposits at the bank.

Q. Defined as what?

A. Vault cash and demand deposits at the Fed. Usually done through deposits at the Fed, although in magnitude the two are about the same.

The deposit at the Fed, the banks keep – comes away being their reserve deposit. And the way that the Federal Reserve controls those reserve deposits is by buying and selling U.S. Government Bonds in the open market. Now, those reserve deposits are subject to day-to-day fluctuations from various causes, including float, including changes in the amount of cash that the public wants to hold, including Treasury operations, international operations.

There are any number of things that can cause bank [p. 14] reserves to change on a day-to-day basis independent of anything that the Federal Reserve does. So what the Federal Reserve attempts to do is to use what we

characterize in the classroom as defensive open market operations. They offset these day-to-day fluctuations in reserves from independent factors by buying and selling U.S. Government Bonds on a short-term basis. Sometimes on a short-term basis is one day or even a few hours. The – it becomes – is greased, if you will. The system works best when the Fed is able to do so using repos.

For instance, let's suppose that reserves – for some reason there is a snow storm over the Rockies and we have trouble getting checks from the East Coast to the West Coast, so that float increases and bank reserves are going to increase. It's known that bank reserves are increasing on a very short-term basis, two or three days.

What the Federal Reserve can do, go in and do two or three repos and the transaction automatically reverses itself two or three days later. So the Fed's ability to conduct monetary policy is enhanced by using the repo market.

Q. Are you familiar with Mr. Sternlight?

A. I don't know him personally. I mean, I know that – he's a heavy hitter.

Q. Um-hmm. Is his job a very sensitive job?

[p. 15] A. Surely.

Q. In the Federal Reserve Bank of New York, where would he be placed; in the top two or three guys?

A. Very clearly.

Q. Was the Federal Reserve Bank of New York heavily involved in bailing out the stock market after the October 19th crash?

A. My understanding, it was, yes.

Q. How did that happen; do you know?

A. The crash or the bail-out?

Q. No, the bail-out.

A. Sure. In essence, what they did, they increased bank reserves and put the liquidity out there in the financial system.

Q. If they had not done that, what would have happened?

A. I don't know. It wouldn't have been pleasant.

MR. PAGES: Do you have a copy of that affidavit that I gave you there from Sternlight?

(Discussion held off the record)

BY MR. PAGE:

Q. If the Fed was not able to use repurchase agreements freely, what would happen to their operations?

A. Nothing, be a little more inconvenient to the open market operations, but they can do it just as well in the [p. 16] Treasury Bill market as in the repo market.

Probably just as well is probably too strong a statement. My understanding and my belief is that they could operate essentially like they've always operated.

Q. So if Mr. Sternlight says that they need repurchase agreements, to retreat [sic] these purchase and sale agreements to operate in the manner they have been, you would disagree with that?

A. I mean, your characterization in the manner in which they have been, clearly they would have to change their procedures a little bit.

I think – I'm very confident if you ask Mr. Sternlight if they could still conduct open market operations in essentially the same way and have the same impact as they do now without repo agreements, he'd tell you, yes, they'd manage fine. They'd have to change their procedures a little bit, but, you know, the system is not going to come apart if the Federal Reserve can't use repo transactions. I'm absolutely confident in making that sort of statement.

MR. PAGE: Okay. Eugene, you got anything else?

MR. MALONEY: (Counsel shakes head)

MR. PAGE: Okay. That's all the questions I have at this point.

MR. BROWN: No questions.

[p. 17] MR. PAGE: Stewart, you want to waive reading and signing, or do you want to have it looked at?

MR. BROWN: Up to you.

THE WITNESS: No.

STIPULATIONS: It is hereby stipulated and agreed to by and between Counsel for the respective parties and the Deponent, that the reading and signing of this deposition be waived.

(Whereupon, this deposition was concluded at 10:36 o'clock, a.m.)

[p. 18] CERTIFICATE

STATE OF FLORIDA :
:
COUNTY OF ORANGE :

I, ABBY L. McCLAIN, being a Stenotype Shorthand Reporter and Notary Public, State of Florida at Large, do hereby certify that I did, at the time and place herein designated, place under oath the Deponent, STEWART BROWN, who was thereupon examined; that said examination was recorded, by me, in Stenotype notes which were later reduced, by me, through computer-aided transcription, to typewritten form; and that the foregoing pages, numbered 3 through 17, inclusive, constitute a true, complete and accurate transcription of my said Stenotype notes taken therein.

I further certify that I am neither of counsel nor related to any party involved in this action, nor am I financially interested in the outcome of this case.

WITNESS MY HAND AND OFFICIAL SEAL, on this, the 2nd day of December, 1987, in the City of Orlando, County of Orange, State of Florida.

/s/ Abby L. McClain
ABBY L. McCLAIN
Court Reporter
Notary Public

My Commission Expires:

March 4, 1991

IN THE DISTRICT COURT OF
LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, vs. STATE OF NEBRASKA, DEPARTMENT OF REVENUE, Defendant.	) Docket 428 Page 177))))))))	SECOND STIPULATION OF THE PARTIES (Exhibit No. 2 Received July 23, 1990)

The parties hereby stipulate that solely for the purposes of this action the following paragraphs shall be taken as true.

1. The Trust for Short-Term U.S. Government Securities and the Trust for U.S. Treasury obligations (the "Trusts") are no-load, open-end, diversified investment companies whose primary objective is to receive current income from ownership of U.S. Government securities and obligations, either directly or through the use of repurchase agreements.

2. The Trusts do not engage in any other business.

3. The Trusts are qualified as regulated investment companies under Internal Revenue Code Subchapter M and are established under the Investment Company Act of 1940.

4. The Trusts are what is commonly known as "mutual funds."

5. The Trusts make U.S. Government securities accessible to investors in much smaller denominations than sold in the marketplace and provide a distribution of the risk through a diversified portfolio of U.S. Government securities.

6. The Trusts invest in short-term securities and obligations of the U.S. Government and its agencies and instrumentalities either directly or through repurchase agreements. The Trusts hold no other securities.

7. The Trusts hold U.S. Government securities and Treasury obligations directly and through repurchase agreements.

8. Each of the federal securities held by the Trusts, either directly or through repurchase agreements, are "obligations of the United States . . . exempt from state income taxes under the laws of the United States" as that term is used in *Neb. Rev. Stat.* § 77-2716 (1988 Cum. Supp.).

9. A typical repurchase agreement used by the Trusts is attached hereto as *Exhibit A*.

10. A standard repurchase agreement ("repo") consists of a two-part transaction.

11. The first part consists of the transfer of specified securities by the seller to the buyer, in exchange for cash.

12. The second part consists of the contemporaneous agreement by the seller to repurchase the securities at the original sale price, plus an agreed upon amount of "interest," paid on a specified future date (the "Maturity Date").

13. Actual delivery is taken of the securities through the Federal Reserve book entry system.

14. There is no separate promissory note executed in connection with the repurchase agreement.

15. The repurchase price of the government securities subject to a repo is typically less than the market value of the securities.

16. For example, in the case of a two percent differential, the buyer will receive $1,020,000 of securities for the purchase price of $1,000,000.

17. The differential provides a margin of financial security for the buyer in case the securities decline in value and the seller fails to repurchase them.

18. The repurchase price of the securities is equal to the original sale price, plus the negotiated interest.

19. The interest paid by the seller upon repurchase is less than the interest rate accruing on the purchased securities.

20. The income earned on each share of the Trusts is each share's proportionate fractional share of the total income realized from the underlying federal securities and obligations owned by the Trusts, after deducting the administrative costs associated with the U.S. obligations.

21. The Trusts have historically distributed all of their net income to their shareholders.

22. On September 11, 1987 Donald S. Leuenberger, then State Tax Commissioner, issued Revenue Ruling 22-87-4, a copy of which is attached hereto as *Exhibit B*.

23. This Ruling requires that for tax years after 1986, dividends from regulated investment companies owning obligations of the U.S. Government must be included within taxable income for purposes of the Nebraska Individual Income Tax unless 80 percent or more of the assets of the Company for every quarter of the taxable year were directly owned U.S. Government obligations.

24. The defendant has advised taxpayers through the instructions included with the Nebraska Individual Income Tax forms for 1987 and subsequent years that repurchase agreements covering U.S. Government securities cannot be counted towards satisfying the 80 percent requirement of this Revenue Ruling.

25. At the end of each quarter of the tax year in 1987 less than 80 percent of the assets of the Trusts consisted of U.S. securities directly owned by the Trusts.

26. As a result of the foregoing Revenue Ruling, defendant maintains that plaintiff's dividends for 1987 and subsequent years received from the Trusts are subject to the Nebraska state income tax.

Dated this 23rd day of July, 1990.

JOHN LOEWENSTEIN, Plaintiff

By CLINE, WILLIAMS, WRIGHT, JOHNSON & OLDFATHER
1900 FirsTier Bank Building
Lincoln, Nebraska 68508
Telephone: (402) 474-6900

By: /s/ Terry R. Wittler
Terry R. Wittler (#15584)

Dated this 23rd day of July, 1990.

STATE OF NEBRASKA,
DEPARTMENT OF REVENUE,
Defendant

By ROBERT M. SPIRE
Attorney General

By /s/ David Edward Cygan
David Edward Cygan,
#18546
Assistant Attorney General
2115 State Capitol
Lincoln, NE 68509-4906
(402) 471-2682

EXHIBIT A

GENERAL REPURCHASE AGREEMENT

From time to time each registered investment company listed on Exhibit A to this agreement, individually but not jointly ("Fund") and ___ ("Seller") may engage in repurchase transactions whereby Seller sells to the Fund obligations issued or guaranteed by the United States Government or agencies thereof, ("Eligible Securities") at a price as may be agreed upon ("Sale Price") and having a market value at least equal to the Margin Percentage (as defined in paragraph 1 below) of the Sale Price, and whereby, on a date fixed by agreement between Seller and the Fund, or, in the absence of such agreement, upon demand by either of them, Seller agrees to repurchase such Eligible Securities from the Fund, and the Fund

agrees to resell such securities and pay over all principal, interest and other sums paid by or on behalf of the issuer in respect thereof collected by the Fund (and not previously paid over to Seller pursuant to paragraph 9 below) to Seller, at the Sale Price plus interest at the agreed upon interest rate ("Interest Rate"), all subject to and in accordance with the following terms and conditions:

1. *Payment and Delivery.* If the Fund and Seller agree to enter into a repurchase transaction, Seller shall sell to the Fund and, on the same day, transfer to the Fund's designated custodian ("Custodian") the agreed upon Eligible Securities, together with all rights related thereto and all proceeds thereof, against the crediting of the Sale Price for such transaction to an account of Seller in immediately available funds. Seller shall take, or cause to be taken, any additional actions as the Fund shall reasonably request, to perfect the Fund's interest in such securities. The "Margin Percentage" shall be 102% or such greater percentage as is agreed upon by Seller and the Fund prior to or upon entering into such transaction. All such Eligible Securities which shall at any time have been sold to Fund and delivered to Custodian and not repurchased hereunder, together with all rights related thereto and all proceeds thereof, shall hereinafter be referred to as the "Securities".

2. *Market Value.* The market value of the Securities shall on any business day be the sum of (1) the bid quotations for such Securities as reported in the immediately preceding business day's *Wall Street Journal* or any other recognized reporting service, as Fund and Seller may agree, plus (ii) the accrued interest on such Securities on the date of determination.

3. *Confirmation.* No later than the next business day following the commencement of each repurchase transaction as described in paragraph 1, Seller shall send to the Fund a confirmation, with a copy to the Custodian setting forth with respect to such repurchase transaction: the Eligible Securities subject thereto; the Sale Price of such Eligible Securities; the applicable Interest Rate; the applicable Margin Percentage; and the date, if any, fixed for termination of the transaction, or a notation that the transaction is terminable upon demand.

4. *Representations of Fund.* The Fund represents that it is duly authorized to enter into this agreement and the transactions contemplated hereby, that this agreement does not violate any ordinance, charter, rule or statute applicable to the Fund and that the person executing this agreement on behalf of the Fund is duly and properly authorized to do so.

5. *Representation of Seller.* Seller represents and warrants that it has the unqualified right to sell, transfer, assign or pledge the Eligible Securities that will become Securities and that such securities, upon delivery to the Custodian, will be free and clear of any lien, claim or encumbrance. Seller further represents that this agreement is legally entered into by Seller, does not violate any ordinance, charter, rule or statute applicable to it and that the person executing this agreement on behalf of Seller has been duly and properly authorized to do so. Seller represents that it does not exercise discretionary authority or control with respect to the investment of the assets of any employee benefit plan or render investment advice (as defined in ERISA) to any such plan, except for plans established for its own employees or those of its affiliates.

6. *Substitution.* At any time and from time to time until the Fund shall make a demand for Seller to repurchase the Securities, or until the date fixed for repurchase in case of repurchase transactions having a fixed term, Seller shall have the right, upon notice given to the Fund by telephone or otherwise no later than 10:00 A.M. New York Time, on a banking day, to repurchase Securities on that day and to substitute by sale on the same day Eligible Securities provided that the market value at the time of such substitution of such substituted securities shall not be less than the Margin Percentage of the Sale Price of the Securities for which substitution is made. Each such substitution shall be effected by the Custodian's delivering to Seller or its agent the Securities to be repurchased against the crediting of the Sale Price for such Securities to an account of the Fund in immediately available funds and by Seller delivering to the Custodian the substituted securities against the crediting of such Sale Price, also in immediately available funds, to an account designated by Seller. When delivered to Custodian such substituted securities shall be considered Securities for all purposes. Seller, upon each substitution, shall prepare and deliver to the Fund an updated schedule of the securities.

7. *Transaction Termination.* In the case of repurchase transactions terminable upon demand, such demand shall be made by the Fund or Seller by telephone or otherwise no later than 10:00 A.M. New York time on the banking day on which such repurchase will be made. On the date of such demand, or on the date fixed for termination in the case of repurchase transactions having a fixed term, termination of the repurchase transaction will be effected

by delivery to Seller or its agent of the Securities and any principal, interest and other sums paid by or on behalf of the issuer in respect thereof collected by the Fund (and not previously paid over to Seller pursuant to paragraph 9 hereof) against the crediting of the Sale Price plus Interest (as described in paragraph 8) to an account of the Fund in immediately available funds.

8. *Interest.* Interest on the Sale Price for each repurchase transaction shall be calculated on the basis of a 360-day year and actual days elapsed and shall be paid upon termination or for such other periods or at such other times as may be agreed upon by Seller and the Fund.

9. *Payments on Securities.* The Fund agrees to pay over to Seller as soon as received all principal, interest and other sums paid by or on behalf of the issuer in respect of the Securities and collected by the Fund, provided, however, that the Fund may retain any such sums as Cash Collateral if the payment to the Seller and would result in the Margin Percentage falling below 102%, unless Seller delivers Cash Collateral or Eligible Securities to the Fund sufficient to meet Seller's obligations under paragraph 10 hereof. The Fund agrees that it will not resell or reregister the Securities unless an event described in paragraph 13 shall have occurred.

10. *Margin Maintenance – Seller's Obligation.* If the market value (as determined in accordance with paragraph 2 above) of the Securities under any repurchase transaction shall at any time be less than the Margin Percentage of the Sale Price applicable to such repurchase transaction, the Fund may upon one business day's notice

to Seller require that Seller or its agent deliver to the Custodian cash ("Cash Collateral") or an additional amount of Eligible Securities from the category of such securities or from other categories acceptable to the Fund the market value of which, together with the market value of the Securities, will equal at least the Margin Percentage of the Sale Price applicable to such repurchase transaction. When delivered to the Custodian, any such additional securities shall be considered Securities for all purposes. Any deliveries of additional securities under this paragraph shall be accompanied or preceded by a statement of Seller as to the individual market values of the additional securities.

11. *Margin Maintenance – Fund's Obligation.* If the market value of the Securities plus the amount of any Cash Collateral under a repurchase transaction shall exceed the Margin Percentage of the Sale Price applicable to such repurchase transaction, Seller may upon one business day's notice to the Fund require that the Fund or its agent return to Seller or its agent that part of the Securities or amount of Cash Collateral specified for return in the market value report described below, provided that the market value of the remaining Securities, in addition to the amount of any Cash Collateral, shall be at least the Margin Percentage of the Sale Price applicable to such repurchase transaction. During the term of any repurchase transaction under this agreement Seller shall furnish to the Fund upon request or at any time upon Seller's initiative a report of the market value of the Securities and any resulting deficiency or excess under this paragraph. Cash Collateral may at any time and from time to time with respect to any repurchase transaction be

withdrawn from pledge against simultaneous delivery to the Custodian for the account of the Fund of Eligible Securities with a market value greater than or equal to the amount of Cash Collateral withdrawn, at which time such Eligible Securities shall become Securities.

12. *Seller's Financial Condition.* Seller has delivered to the Fund copies of its most recently available annual audited financial statements as well as its most recently available unaudited financial statements and shall furnish additional audited and unaudited statements of its financial condition as they are issued. Seller represents that such statement fairly represents its financial condition and net capital ratio as to the date of that statement. Seller also represents that there has been no material adverse change in its financial condition or net capital ratio since that date. Seller shall promptly deliver to the Fund all statements subsequently required to be furnished to Seller's customers by such rule. Seller agrees that its agreement to enter into each repurchase transaction shall constitute a representation that there has been no material adverse change in its financial condition since the date of the latest such statement which the Seller has not disclosed to the Fund in writing. Seller has also delivered to the Fund its most recent financial information otherwise available to the public and, as long as any repurchase transaction is outstanding under this agreement, will promptly deliver to the Fund any such financial information subsequently available.

13. *Seller Events of Default.* The occurrences of any of the following shall constitute a "Seller Event of Default":

(a) If the Sale Price is not repaid to the Fund as specified in paragraph 7;

(b) If any interest is not paid to the Fund as specified in paragraph 8, and such default is not cured within one business day after notice;

(c) If Seller shall fail to maintain the Margin Percentage as provided in paragraph 10, and such default is not cured within one business day after notice;

(d) If the representations about Seller's financial condition made under paragraph 12 shall have been incorrect in any material respect when made;

(e) If Seller shall make a general assignment for the benefit of creditors; admit in writing its inability to pay its debts as they become due; file a petition in bankruptcy or a petition seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any present or future bankruptcy, reorganization, insolvency or similar statute, law or regulation or seek the appointment of any trustee, receiver custodian or liquidator of Seller or of all or substantially all of its properties;

(f) If a proceeding is commenced against Seller seeking relief or an appointment of a type described in paragraph 13(e) above and such proceeding is not dismissed within 30 days after the commencement thereof;

(g) If Seller shall have defaulted under this agreement by operation of clause (a) of the second sentence of paragraph 20 below, and such default is not cured within one business day after notice.

14. *Fund's Rights Upon Seller's Default.* If a Seller Event of Default shall have occurred and be continuing, the Fund may, upon one business day's prior notice to Seller (which notice may be the same notice referred to in paragraph 13(b), (c) or (k) and shall not be required to be given in advance in the case of a Seller Event of Default of a type described in paragraph 13(e) or (f)), (a) terminate or accelerate to a date designated by Fund the date fixed for termination of the directly affected repurchase transaction or all of the repurchase transactions hereunder and (b) apply the Securities to the payment of the Sale Price, plus accrued and unpaid interest at the Interest Rate thereon, all reasonable legal or other expenses incurred by the Fund as a result of Seller's default, and, to the extent permitted by applicable law, interest on such accrued and unpaid interest and expenses at the Interest Rate until the obligations of Seller under this agreement have been satisfied by (i) selling the Securities in the principal market for such Securities in a commercially reasonable manner; or (ii) in lieu of sale, by registering or causing to be registered to the account of the Fund the transfer of any securities held by the Custodian free and clear of all interests of the Seller. If any Securities or proceeds of Securities remain after all obligations of Seller under this agreement have been satisfied, the Fund or the Custodian shall promptly return to Seller or its agent the balance of the Securities or proceeds of Securities. Any Cash Collateral held by the Fund shall be applied by the Fund to the amount owed by the Seller and any excess shall be remitted to the Seller. If the Securities are not sufficient to satisfy all such obligations, Seller shall be liable to the Fund for the amount of

remaining obligations plus interest at the then prevailing Effective Federal Funds Rate.

15. *Fund Events of Default.* The occurrence of any of the following shall constitute a "Fund Event of Default:"

(a) If the Sale Price is not paid as specified in paragraph 1 above;

(b) If the Fund shall fail to perform its obligations under paragraph 6 above in respect of a substitution of Securities, and such default is not cured within one business day after notice;

(c) If the Fund shall fail to pay any amount required pursuant to paragraph 9 above, and such default is not cured within one business day after notice;

(d) If the Fund shall fail to return excess Securities as provided in paragraph 11 above, and such default is not cured within one business day after notice;

(e) If the representations made by the Fund in paragraph 4 above shall have been incorrect in any material respect when made;

(f) If the Fund shall make a general assignment for the benefit of creditors; admit in writing its inability to pay its debts as they become due; file a petition in bankruptcy or a petition seeking any reorganization, arrangement, composition, readjustment, liquidation, dissolution or similar relief under any present or future bankruptcy, reorganization, insolvency or similar statute, law or regulation or seek the appointment of any trustee, receiver, custodian or liquidator of the Fund or of all or substantially all of its properties;

(g) If a proceeding is commenced against the Fund seeking relief or an appointment of a type described in paragraph 15(f) above and such proceeding is not dismissed within 30 days after the commencement thereof;

(h) If a final judgment for the payment of money shall be rendered against the Fund, and such judgment shall not have been discharged or its execution stayed pending appeal within 60 days of entry or such judgment shall not have been discharged within 60 days of expiration of any such stay; or,

(i) If the Fund shall have defaulted under this agreement by operation of clause (a) of the second sentence of paragraph 20 below, and such default is not cured within one business day after notice.

16. *Seller's Rights Upon Fund Default.* If a Fund Event of Default shall have occurred and be continuing, Seller may, upon one business day's prior notice to Fund (which notice may be the same notice referred to in paragraph 15(b), (c), (d) or (i) above and shall not be required to be given in advance in the case of Fund Event of Default of a type described in paragraph 15(f) or (g)), (a) terminate or accelerate to a date designated by Seller the date fixed for termination of the directly affected repurchase transaction or all repurchase transactions hereunder and (b) purchase in the principal market therefor in a commercially reasonable manner Eligible Securities with a market value equal to any Securities required to be returned or delivered by Fund but not so returned or delivered, or elect to be deemed for all purposes of this agreement to have purchased such Securities, and in either event apply

the cost of such purchase (including any reasonable expenses incurred in connection therewith) or, in the case of a deemed purchase, the market value of such Securities as of the date of such deemed purchase, against the Sale Price and any other amounts owing by Seller, upon which application the Sale Price and any such other amounts shall be reduced by the amount so applied, Seller shall be released from the obligation to pay any part of the Sale Price other than the positive amount, if any, of the Sale Price after such reduction and Fund shall be released from any obligation to sell, return or deliver such Securities. Seller shall promptly pay Fund any portion of such positive amount (after such reduction) which has not previously been paid. Fund shall pay promptly to Seller any excess of such cost of purchase of replacement Eligible Securities (including expenses as aforesaid) or, in the case of a deemed purchase, such market value of such Securities over the amount of the Sale Price (prior to reduction), plus interest at the applicable Interest Rate on such excess for the period from the date of such purchase or deemed purchase until the date of full payment by Fund at the then prevailing Effective Federal Funds Rate. Notwithstanding anything contained in this agreement, except as expressly provided for in this paragraph 16 Seller shall under no circumstances whatsoever have any obligation or liability to Fund in respect of any repurchase transaction following the failure of Fund to pay the applicable Sale Price or return or deliver the applicable Securities as and when required by the terms of this agreement.

17. *Notices.* Except as otherwise expressly provided herein, all notices under this agreement shall be telephonic or written and given to the party entitled to

receive such notices at the following telephone numbers and addresses:

If to Seller:

Attention:

If to Fund: ----------

(Name of Fund)
421 Seventh Avenue
Pittsburgh, PA 15219
Attention: Peter C. Hurley
(412) 288-1975

or to such other telephone numbers or addresses as either party may furnish the other party by written notice under this paragraph. All written notices which are required or provided to be given hereunder shall be effective upon actual receipt by the party to which such notice is given.

18. *Security Interest.* Notwithstanding any other provision of this agreement, in the event that a repurchase transaction hereunder is deemed not to be a sale (a) Seller shall be deemed to have hereby granted to the Fund a first security interest in and a lien upon, and to have pledged the Cash Collateral and Securities (together with all principal, interest and other sums paid by or on behalf of the issuer in respect of the Securities and collected by the Fund and all rights related thereto, all proceeds thereof and all substitutions therefor) applicable to such repurchase transaction as security for the performance by Seller of its obligations in respect of such repurchase transaction and (b) the existence of such first security interest, lien and pledge shall be deemed not to violate the representations and warranties in respect of such

Securities made by Seller in paragraph 5 above. Notwithstanding the foregoing sentence, it is the intention of the Seller and the Fund that each such transaction shall be a "sale" within the meaning of the New York Uniform Commercial Code.

19. *Segregation.* All Securities and Cash Collateral held by the Custodian for the account of the Fund shall be segregated from other securities and cash in the possession of the Custodian and shall be identified as subject to this agreement. Segregation may be accomplished by appropriate identification on the books and records of the Custodian.

20. *Single Agreement.* Seller and Fund hereby acknowledge that they consider all transactions and agreements between them to constitute a single business and contractual relationship and to have been made in consideration of each other and this agreement. Therefore, (a) each party hereby agrees to fulfill all of its obligations to the other party with respect to any transaction or agreement between them, and agrees that a default in the performance of any such obligations shall constitute a default hereunder, (b) each party shall have a right of setoff against the other party of amounts owing hereunder and any other amounts or obligations owing in respect of any other agreement or transaction whatsoever, and (c) payments and deliveries made by either party hereunder shall be considered to have been made in consideration of payments and deliveries made by the other party with respect to any other agreement or transaction between them, and the obligations to make any such payments and deliveries may be applied against each other and netted.

21. *Termination of Agreement.* This agreement may be terminated by either party on ten business days' written notice to the other party; provided, however, that such termination shall not affect any repurchase transaction then outstanding or initiated thereafter and prior to the date of termination specified in such notice.

22. *General Provisions.* This agreement supersedes any other agreement between the parties concerning repurchase transactions, except for the additional terms and conditions appearing on each confirmation delivered pursuant to paragraph 3, shall not be assignable by either party without prior written consent of the other party, shall be binding upon and inure to the benefit of the parties and their respective successors and assigns, shall not be changed except by an instrument in writing signed by each of the parties, and shall be governed by the laws of the State of New York.

---------- (SELLER)

---------- By ----------
Date (Title)

FUND*

---------- By ----------
Date Vice President

---

* This agreement is executed on behalf of each Fund listed on Exhibit A to this agreement. John A. Staley, IV, is duly and properly authorized by each Fund listed on Exhibit A to this agreement to enter into this agreement on its behalf.

EXHIBIT A

AARP U.S. GOVERNMENT MONEY MARKET TRUST
AMERICAN LEADERS FUND, INC.
AUTOMATED CASH MANAGEMENT TRUST
AUTOMATED GOVERNMENT MONEY TRUST
BOSTON FOUNDATION FUND INCORPORATED
EGT MONEY MARKET TRUST
FEDERATED CAPITAL APPRECIATION FUND, INC.
FEDERATED CORPORATE CASH TRUST
FEDERATED EXCHANGE FUND, LTD
FEDERATED GNMA TRUST
FEDERATED GOVERNMENT SECURITIES TRUST
FEDERATED GROWTH TRUST
FEDERATED HIGH INCOME SECURITIES
FEDERATED HIGH YIELD TRUST
FEDERATED INCOME TRUST
FEDERATED INTERMEDIATE GOVERNMENT TRUST
FEDERATED MASTER TRUST
FEDERATED MORTGAGE SECURITIES INCOME FUND
FEDERATED SHORT-INTERMEDIATE GOVERNMENT TRUST
FEDERATED SHORT-INTERMEDIATE MUNICIPAL TRUST
FEDERATED STOCK TRUST
FORT WASHINGTON MONEY MARKET FUND
FUND FOR U.S. GOVERNMENT SECURITIES
GOVERNMENT MONEY INSTRUMENTS TRUST
EDWARD D. JONES & CO. DAILY PASSPORT CASH TRUST
LEGG MASON CASH RESERVE TRUST
LIQUID CASH TRUST
LUTHERAN BROTHERHOOD FUND
LUTHERAN BROTHERHOOD INCOME FUND
LUTHERAN BROTHERHOOD MONEY MARKET FUND
LUTHERAN BROTHERHOOD MUNICIPAL BOND FUND
MONEY MARKET INSTRUMENTS TRUST

MONEY MARKET MANAGEMENT
MONEY MARKET TRUST
MORGAN KEEGAN DAILY CASH TRUST
SUTRO MONEY MARKET FUND
TRUST FOR CASH RESERVES
TRUST FOR SHORT-TERM U.S. GOVERNMENT SECURITIES
TRUST FOR U.S. TREASURY OBLIGATIONS

---------- Seller
---------- Fund

EXHIBIT B

(LOGO) nebraska department of revenue

Revenue Ruling 22-87-4
Supersedes Rev. Rul. 22-87-1

Individual Income Tax – Dividends Received from a Regulated Investment Company for Tax Years After 1986. IF FOR EVERY QUARTER OF THE TAXABLE YEAR, 80 PERCENT OR MORE OF THE ASSETS OF A REGULATED INVESTMENT COMPANY ARE DIRECTLY OWNED UNITED STATES GOVERNMENT OBLIGATIONS, THE ENTIRE DIVIDEND RECEIVED FROM THE REGULATED INVESTMENT COMPANY IS EXEMPT FROM NEBRASKA INDIVIDUAL INCOME TAX. IF FOR EVERY QUARTER OF THE TAXABLE YEAR, 80 PERCENT OR MORE OF THE ASSETS OF A REGULATED INVESTMENT COMPANY ARE DIRECTLY OWNED OBLIGATIONS OF ANY STATE, THE DISTRICT OF COLUMBIA, OR THEIR INSTRUMENTALITIES, THE PORTION OF

THE INCOME ATTRIBUTABLE TO NEBRASKA OBLIGATIONS DOES NOT HAVE TO BE ADDED TO ADJUSTED GROSS INCOME FOR NEBRASKA INDIVIDUAL INCOME TAX PURPOSES.

Advice has been requested concerning whether distributions by a regulated investment company investing in U.S. Government obligations or state municipal obligations are subject to Nebraska individual income tax.

A regulated investment company meeting the requirements for classification under sections 851 and 852 of the Internal Revenue Code is not taxed on amounts distributed to shareholders. The shareholders receiving dividends are liable for income tax depending upon the type of income distributed.

Nebraska law provides that if for every quarter of the taxable year, 80 percent or more of the assets of a regulated investment company are directly owned United States Government obligations, the entire dividend for the taxable year received from the regulated investment company is exempt from Nebraska individual income tax. If for any one quarter of the taxable year, less than 80 percent of the assets of a regulated investment company are directly owned United States Government obligations, the entire dividend for the taxable year is subject to Nebraska individual income tax. For a list of obligations considered U.S. Government obligations, see Revenue Ruling 22-87-2 and the instructions to the Nebraska Individual Income Tax Return, Form 1040N.

If for every quarter of the taxable year, 80 percent or more of the assets of a regulated investment company are directly owned obligations of any state, the District of

Columbia, or their instrumentalities, the portion of the dividend attributable to Nebraska obligations does not have to be added to adjusted gross income for Nebraska individual income tax purposes. If for any one quarter of the taxable year, less than 80 percent of the assets of a regulated investment company are directly owned obligations of any state, the District of Columbia, or their instrumentalities, the entire dividend for the taxable year is subject to Nebraska individual income tax.

APPROVED:

/s/ Donald S. Leuenberger
Donald S. Leuenberger
State Tax Commissioner

September 11th, 1987

(LOGO) nebraska department of revenue

Revenue Ruling 22-87-2

Individual Income Tax – Deduction of Income From United States Government Obligations for tax years after 1986.

ALLOWABLE DEDUCTIONS FROM FEDERAL ADJUSTED GROSS INCOME FOR NEBRASKA INDIVIDUAL INCOME TAX PURPOSES ARE ONLY THOSE ITEMS SUBJECT TO FEDERAL TAXATION BUT EXEMPT FROM STATE TAXATION UNDER THE LAWS OF THE UNITED STATES.

Advice has been requested whether interest or dividend income from United States government obligations is deductible for Nebraska individual income tax purposes.

Nebraska law provides that interest or dividends from obligations of the United States and its territories and possessions or of any United States authority, commission, or instrumentality, if included in federal gross income but exempt from state income taxation under the laws of the United States, shall be subtracted from federal adjusted gross income. Section 77-2716(1), R.S.Supp., 1987.

Interest or dividend income included in federal adjusted gross income from the following sources is deductible for Nebraska individual income tax purposes:

(1) United States government bonds, such as series HH and EE, (interest is deductible only if the bond has been issued after March 1, 1942);

(2) United States Treasury Bills (interest is deductible only if the bill has been issued after March 1, 1942);

(3) United States government notes;

(4) United States government certificates;

(5) Commodity Credit Corporation;

(6) Federal Home Loan Banks;

(7) Federal Reserve Banks (dividends are deductible only if from stock issued after March 1, 1942);

(8) Federal Savings and Loan Insurance Corporation;

(9) Tennessee Valley Authority securities;

(10) Interest on debentures issued to mortgagees of mortgages foreclosed under provisions of the National Housing Act if insured after February 3, 1938;

(11) Postal Service bonds;

(12) Retirement bond as provided for by I.R.C. section 409 (issuance discontinued after April 30, 1982);

(13) Farm Credit Bank Consolidated System Wide bonds;

(14) Farm Credit System including the following members unless noted elsewhere:

a. Federal Land Banks (dividends are deductible only if from stock issued after March 28, 1942),

b. Federal Land Bank Association (dividends are deductible only if stock issued after March 28, 1942),

c. Federal Intermediate Credit Banks,

d. Any other institution chartered by and subject to the supervision of the Farm Credit Administration unless noted elsewhere;

(15) General Services Administration Participation Certificates.

Interest but not dividend income included in federal adjusted gross income from the following sources is deductible for Nebraska individual income tax purposes:

(1) Federal Deposit Insurance Corporation;

(2) Student Loan Marketing Association;

(3) Production Credit Association;

(4) Banks for Cooperatives.

Interest or dividend income received from the following sources is taxable and cannot be deducted from federal adjusted gross income for Nebraska individual income tax purposes:

(1) Federal or State Banks;

(2) Federal or State Savings and Loan Associations;

(3) Building and Loan Associations;

(4) Postal Savings Accounts (discontinued in 1966);

(5) Export Import Bank bonds;

(6) Federal or State Credit Unions;

(7) Interest on debentures issued to mortgagees of mortgages foreclosed under the provisions of the National Housing Act if insured prior to February 3, 1938;

(8) Interest on federal income tax refunds;

(9) Farmers Home Administration;

(10) New Community debentures;

(11) Merchant Marine bond;

(12) Ship Financing bond;

(13) U.S. Merchant Marine Ship notes;

(14) U.S. Merchant Marine Offshore Ship Service notes;

(15) Interest on state income tax refunds;

(16) Federal Home Loan Mortgage Corporation;

(17) World Bank;

(18) International Bank for Reconstruction and Development bonds;

(19) Asian Development Bank notes and bonds;

(20) InterAmerican Development Bank bonds;

(21) Interest from U.S. Government Life Insurance (unless exempted by I.R.C. section 101(d)(1)(B);

(22) Bankers' Acceptances;

(23) Certificates of Deposit;

(24) Penn Central Transportation certificates;

(25) Federal Financing Bank;

(26) Federal National Mortgage Association;

(27) Government National Mortgage Association;

(28) Chrysler Corporation secured notes;

(29) Lockheed convertible bonds;

(30) Washington Metropolitan Area Transit Authority Bonds.

The specific source and dollar amount of each item claimed as income from the U.S. government is to be identified on Nebraska Schedule I or on an attached sheet and filed with Form 1040N. Failure to provide adequate information shall result in the disallowance of part or all of the claimed deduction from federal adjusted gross income.

The items that are allowable deductions from federal adjusted gross income for Nebraska individual income tax purposes are only those items includable in gross income for federal income tax purposes but exempt from state income tax under the laws of the United States.

APPROVED:

/s/ Donald S. Leuenberger
Donald S. Leuenberger
State Tax Commissioner

September 2nd, 1987

IN THE DISTRICT COURT OF
LANCASTER COUNTY, NEBRASKA

JOHN LOEWENSTEIN, Plaintiff, v. STATE OF NEBRASKA DEPARTMENT OF REVENUE, Defendant.	Docket 428 Page 177 AFFIDAVIT (Exhibit No. 3 Received July 23, 1990)

STATE OF NEBRASKA)
)
COUNTY OF LANCASTER)

COMES NOW the affiant, having been first duly sworn, hereby makes oath as follows:

1. I am Donald O. Ellingson. I reside at Rural Route 1, Denton, Nebraska 68339. I am an employee of the Nebraska Department of Revenue. I am a Tax Law Manager in the Tax Policy Division. I am an attorney and an accountant. I am a member of the Nebraska State Bar Association and have passed the CPA exam. I have also completed some graduate work in accounting at the University of Nebraska.

2. As a Tax Law Manager in the Tax Policy Division, my responsibilities include:

a. Researching and drafting proposed legislation,

b. Resolution of technical tax issues,

c. Formulation of positions for the Department,

d. Preparation and presentation of legislative testimony on tax issues,

e. Reviewing forms, rulings, and other publications for technical accuracy and overall consistency.

Within the scope of my responsibilities with the Nebraska Department of Revenue, I have had opportunity to examine repurchase agreements several different times and am familiar with them. I have been involved with the development of the position of the Nebraska Department of Revenue in regard to taxation of repurchase agreements.

3. For the purposes of my discussion of my conclusions on repurchase agreements, I will use the following transaction, which I have found to be a typical transaction based upon my research.

Example No. 1

The bank is the owner of federal bonds. The bank will enter into a repurchase transaction with a fund. The bank will transfer bond to the fund and the fund will transfer money to the bank. The bank will repurchase the bond in three days at a specific price and rate of interest.

4. This is typical of the transactions that I have examined in the relation to their taxability and is a transaction that would be entered into under the sample agreement that is attached hereto and incorporated by reference as Exhibit A. The sample agreement was provided by another taxpayer in a similar situation who

requested an opinion of taxability of the transaction from the Nebraska Department of Revenue. This sample agreement is typical of the agreements that I have seen. This agreement covers repurchases that have a specific date for the purchase, or those that are on demand. I have used the sample agreement for the purposes of this Affidavit since the taxpayer has not furnished any copies of the actual repurchase agreements that have been entered into.

5. I have noted that there are several very important provisions in the sample agreement that were considered by the Department of Revenue and myself in determining the taxation of the income received on repurchase agreements.

a. The purchase price for the bond will be the amount paid for the bond by the fund, plus the amount of interest that will have accrued before the repurchase of the bond.

b. The bank reserves the right to substitute another bond of equal market value for the bond transferred before the repurchase.

c. If the value of the bond drops below the margin percentage, the bank will have to provide an additional bond to insure that the market value of the bonds held by the fund are higher than the margin percentage. A similar provision would require the fund to return a bond if the market value of the bonds exceeded the margin percentage.

d. Any amounts of interest or principal received by the fund from the United States have to be turned over to the bank.

e. The bank has to provide information on its financial condition to the fund, and to keep the fund updated on changes in its financial condition.

f. The agreement contains the grant of a security interest in the bond in favor of the fund by the bank if the agreement is not considered to be a sale and repurchase.

g. The agreement also contains a provision that the agreement is considered one agreement and that the various parts of the agreement are made in consideration of the other parts of the agreement.

6. In evaluating these agreements for the Nebraska Department of Revenue, I have looked at the above terms to determine if the agreement does in fact constitute a sale in [sic – and] repurchase, or if the agreement is a financing arrangement with the bonds held by the bank being transferred as collateral.

7. Basically, the funds want us to look at each of the steps of the agreement separately. Myself and the Department consider the pieces of the agreement as a series of separate transactions. When I do so, I am aware that some of the courts have looked at this as a series of transactions. I am aware that generally these courts have been looking at a situation that would prevent the completion of the remainder of the agreement, such as bankruptcy, where the court has been looking at whether public bodies that are not able to make loans can participate in the repurchase agreements.

8. I am also aware that generally in taxation matters, the transaction is viewed as a whole. The steps are

normally collapsed or ignored to prevent a tax benefit solely because of the form or step structure of the transaction, especially in situations like this where the various steps are interdependent and each step is a part of their consideration of the next step [please see item 5(g) above].

9. I am also aware that the Internal Revenue Service has used this approach when evaluating repurchase agreements on municipal or state obligations. I know that the IRS has not allowed the income on repurchase agreements to be excluded from federal taxations. I am aware that the courts which have looked at this issue for the purposes of taxation have generally looked at the substance rather than the form of the transaction.

10. In viewing the economic substance of the agreement, I note that the bank owns the bond before the transactions begin and it owns the same bond after the transaction is over. I note that the bank had the use of the fund's money for a period of time, and the fund has earned some interest. I note further that the amount of interest was based on the agreement, and not on the interest rates of the bond.

11. I conclude that by agreeing to the repurchase price, the bank isolated the fund from any risk of a decrease in the value of the bonds. The fund was limited in what it could do with the bond prior to a default by the bank. Effectively during the period before the repurchase, the bank retains title to the bonds which are transferred as security for the loan from the fund to the bank.

12. The transaction is viewed by myself and the Nebraska Department of Revenue as a collaterized loan.

Therefore, the income received by the fund is from the bank under the agreement, and is not interest from the United States on a U.S. obligation. Since the interest is not from U.S. obligations, the income can't be excluded from state taxation.

13. I was also connected with the drafting of the legislation on the state taxation of distributions from mutual funds that hold federal obligations. I assisted with the drafting of the current Nebraska statutes which allow for the exclusion by a shareholder of the income received from a mutual fund that holds at least 80% of its assets and federal obligations. If the fund holds less than 80% of its assets and federal obligations, the income from the fund is taxed.

14. It was my intention when participating in the drafting of the Nebraska statute to base it on the federal rules established from mutual funds that hold municipal obligations. Generally the character or source of income received by another entity is lost when the income is transferred to an individual investor. An investor in General Motors can't exclude a portion of the dividends received because GM had income from government obligations.

15. I am aware that the federal tax code allows an exception for certain entities, including mutual funds, under certai circumstances. The same 80% rule used by Nebraska is applied by the Internal Revenue Code to determine whether distributions from mutual funds holding municipal obligations can be excluded from federal income taxation.

16. Our state has adopted the federal rules on preserving the character of the income when received by the investor. When the fund does not have enough of its assets and [sic – in] proper securities, the income is considered to be received from the fund and is taxable at either the state or federal level. When a percentage is met, then the income is considered to retain its character and it can be included [sic – excluded] from either state or federal taxation.

17. I have reviewed the attached deposition of Stewart Brown, attached hereto and incorporated as Exhibit B. I concur with the conclusions presented therein and adopt them as my own.

Further affiant sayeth not.

/s/ Donald O. Ellingson
Donald O. Ellingson

Subscribed and sworn to before me this 23rd day of July, 1990.

/s/ Sharon S. French
Notary Public
GENERAL NOTARY
State of Nebraska
SHARON S. FRENCH
My Comm. Exp. Oct. 26, 1993

(Attachments To Exhibit 3 Omitted In Printing).